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BUSINESS PLANNING FOR SMALL BUSINESS CLIENTS (Part II)

Once you have determined your client's business objectives and policies and have assembled sufficient data and information (see part 1 in last month's *Practicing CPA*), you will be able to provide significant help in the company's planning for management improvement.

There are always better ways of doing things. For example, the company may be able to justify the initial expense of a word processing system as opposed to buying ordinary typewriters. So, set up a capital equipment replacement program for your client. Decide what needs to be replaced and when, and determine the source of necessary money.

Make sure that key personnel are adequately trained and that leadership qualities are developed. These steps are often neglected in small businesses where the founders are still in charge. Check that there are policies which encourage the purchasing staff to work closely with suppliers in order to obtain the best value for money spent.

The whole organization should become a closely knit unit the primary aim of which is customer satisfaction. Somebody in the firm has to sell customer service, so see to it that a competent sales organization is developed (even if it's only one person). Work with the client to ensure that good employee and public relations are established.

Budgets must be set up to control both direct and indirect expenses. This will be the time to eliminate unnecessary fringe items and to do some forecasting for future sales, expenses and profits.

You must convince your client of the important advantages to be gained from budgeting. You can point out, preferably in a letter, that planning is made more exact when specific quantities of merchandise and supplies, the number of hours involved and the various costs incurred are all set down in a budget. Then, choosing alternatives and coordinating activities are made easier.

Show your client how control can be facilitated by comparison of the planned figures with actual results, and how costs can be reduced if there is an awareness of them. Show how budgeting can be helpful in establishing performance standards in key areas of the company—an important aid in motivating employees.

Explain a few more budget details if necessary. Tell your client that the sales budget is based on the company's past performance and on indexes and forecasts of business conditions put out by trade associations, etc. The budget can determine what products are to be sold, how they are to be sold, in what amounts and at what prices. However, the budget must be flexible so that new products can be included.

Point out that the purchase budget depends on the level of sales, the inventory on hand at the start of the period and the desired inventory at the end. Explain that the reasons for taking inventory are to prevent delays due to a shortage of parts or materials and to economize on purchases through anticipation of price increases.

Let your client know which areas are covered in expense budgets. Mention items such as the payroll, travel and entertainment, supplies, services, taxes and building occupancy costs.

Here is a checklist of basic tools for business guidance that you can show your client. You probably have many of them already and can help develop others.

What's Inside . . .

BASIC TOOLS FOR BUSINESS GUIDANCE

Tools for Long-range Planning and Control

1. The long-range forecast of demand.
2. The definitely-stated, long-range sales goal.
3. The comparison of factory capacity and distributive capacity with the long-range sales forecast.
4. The long-range expansion plan.
5. The long-range financial program.
6. The annual comparison of accomplishments with the long-range sales goal, the long-range expansion plan and the long-range financial program.

Tools for Short-range Budgetary Control

7. The general budget.
8. The estimated statement of profit and loss.
9. The short-range forecast of demand.
10. The production schedule or budget.
11. The inventory formula.
12. The sales budget.
13. The purchase budget.
14. The labor budget.
15. The manufacturing expense budget.
16. The selling and administrative expense budgets.
17. The advertising budget.
18. The break-even calculation.
19. The estimated balance sheet.
20. The table of financial ratios.
21. The cash budget and financial program.
22. The plant and equipment budget.
23. The comparisons of the budgets with operating results.

Production Control Devices

24. The general summary of production, shipments and inventory.
25. The general report of production expense.
26. The statement of production and labor cost per pound and per unit.
27. The percentages or indexes of plant and equipment utilization and related data.
28. The factory inventory report.
29. The general report on production labor.
30. The factory shipment report.

Tools for Sales Direction and Control

31. The sales quotas.
32. The market index.
33. The general report of sales.
34. The comparison of sales with the sales quotas and the potentials shown by the market index.
35. The report and analysis of selling costs.
36. The summary of selling expenses.
37. The report of collection quotas and collection results.
38. The apparatus for management of the individual salesman.
39. The general indicators of sales activity and success.

Advertising Control Devices

40. The tools for controlling advertising.

Inventory Control Tools

41. The inventory budget and report.
42. The dollar open-to-buy controls and the unit stock controls.
43. The special reports of stock conditions.

Special Executive Tools (Tailor them for the client)

44. The monthly progress report.
45. The danger flag report.
46. The special analyses of trouble spots.
47. The indexes of economic and business activity.
48. The summary of general economic conditions and appraisal of their effect on the business.
49. The division of the sales dollar into its component parts.
50. The audit of management.

This is the second of two articles by William J. Storm, New Orleans, Louisiana.

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MAS Training Program

The AICPA's National MAS Training Program will be held at the University of Texas-Austin during the weeks of June 17-22 and June 24-29.

The first week's program "Development of Consulting Skills," is designed for practitioners with less than two years' experience in MAS whether or not their firms have formal MAS departments. Some of the major topics to be covered include: engagement planning, scheduling, conduct and documentation; systems design and implementation; analytical and problem-solving processes; and small business consulting.

During the second week, MAS practitioners with two to three years' professional experience can receive training in directing an engagement in designing and implementing a financial planning and control system for a small business client. Among the subjects to be discussed are information systems and organization objectives; MAS approach to financial control systems analysis and design; manufacturing control systems and planning; marketing control systems and planning; financial objectives and organization; and decision making.

Instruction will consist of lectures by a nationwide faculty of outstanding, experienced practitioners as well as small group application sessions led by University of Texas Graduate School of Business faculty members.

The cost for each week will be $575 for tuition and $150 for room and board. For further information, contact Stacy Kosmides at the AICPA.

A Tax Engagement Letter

Although an engagement letter is not a professional requirement, the use of one is a sound business practice. An engagement letter covers the scope of services rendered and the responsibility assumed by the CPA firm and, consequently, should be prepared with considerable care.

Every letter covering audit, unaudited or accounting services should point out the limitations in the CPA's responsibility for the discovery of fraud and other irregularities. Similarly, any limitations that a client imposes on the extent of an audit should be stated. The terms of billing and payment should be included, and a complete description should be given of any unusual or extraordinary services that are to be performed.

Engagement letters should be used for every engagement, although interim audits or unaudited financial statement preparation can be provided for in one annual letter. Clients should be sent two copies of an engagement letter, so that one may be signed and returned for the CPA's file.

There are several good reasons for using engagement letters. They help avoid misunderstandings with clients over terms and conditions of engagements and with staff members over what is required of them, such as the type of financial statements they are to examine, when they are to do so and the type of opinion or disclaimer that is contemplated. And, they can assist auditors plan appropriate audit steps and procedures.

Aside from defining the contractual obligations, engagement letters make it easier for partners and staff members to review the services performed and the terms of engagements, and draft extensions or amendments where needed.

Chapter 204 of the AICPA *Management of an Accounting Practice Handbook* contains a number of sample engagement letters. Here is one that pertains specifically to the representation of a client before the Internal Revenue Service. It was sent in by Ralph C. Kuhn, Jr., CPA, and will be used in the 1979 handbook supplement which should be available about mid-July.

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Member:
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American Institute of Certified Public Accountants

December 14, 19__

John and Mary Smith
2624 Bank St.
Los Angeles, Ca 90057

Dear Mr. and Mrs. Smith:

This letter is to confirm our understanding of the terms of our engagement and the nature and extent of the tax services we will provide.

We will represent you before the Internal Revenue Service and exert our best efforts to obtain a satisfactory settlement of any issues that may arise in the examination of your 19__ individual federal income tax return.

We will make no audit or other verification of the data you have submitted, although we may ask for clarification of some of the information.

Our fee will be based upon the amount of time required for such services at our standard billing rates for tax work, plus out-of-pocket expense. We will bill you on that basis, and all invoices will be due and payable upon presentation.

If the above fairly sets forth our understanding, please sign the enclosed copy of this letter and return it to us.

We are pleased to have you as a client and look forward to a long and mutually satisfying relationship.

Very truly yours,

CARPENTER, KUHN & WILLIAMS

Ralph C. Kuhn, Jr.
Partner

RCK:pr

Approved:

By:______________________ Date______________

Partner Selection, Admission and Retention

The objective of partner selection is to admit those candidates who can clearly contribute to the firm's viability in the years ahead. Most sought are men and women of breadth and judgment who have a practice development consciousness and a full appreciation of the need for an extremely high level of technical competency. For them, an expanded role involving an assumption of leadership and greater responsibility in the firm within a five-year period should be envisioned.

People should be considered for their partnership potential when they are interviewed for staff positions. Most partners like the idea of continuity but if staff accountants who are expected to continue the firm are to be hired, everyone concerned must be aware of the firm's philosophy. The present partners must decide what they want their firm to do and where they want it to go; and they must find out what staff people and prospective staff members would like to be doing in five-years' time and what they think they will be doing. If these staff members don't envision substantial improvement in their positions over a five-year period, they probably won't be wanted as partners.

The following profile form and characteristic descriptions may be helpful when considering someone as a potential partner.

Five characteristics of a partner/principal

- ☐ *Leadership* is the ability to motivate and guide subordinates and be respected by them. It means being able to conceptualize a problem and being innovative and creative in reaching a solution. Leadership is the ability to inspire clients and assume responsibility and authority with discretion and judgment. Leadership is the capacity for being an effective manager and achieving the timely completion of assignments.
- ☐ *Technical competence* signifies that one has acquired a body of knowledge in a specialized field and can make sound decisions based on this knowledge. It denotes having confidence in one's technical ability, keeping up with current developments and producing high quality reports for clients. A technically competent person will have sufficient knowledge of the total services offered by the firm to recognize needs and opportunities beyond his own capabilities.

PARTNER CANDIDATE
PROFILE AND NARRATIVE ASSESSMENT

Provide a profile rating of the candidate. The "average" category should be used for acceptable to good ratings. The "superior" rating should be reserved for candidates exhibiting clearly outstanding characteristics. "Below average" ratings should be explained.

PROFILE

Characteristics	*Superior*	*Average*	*Below Average*
Leadership			
Technical Competence			
Contribute to Growth			
Business Sense			
Executive Presence			

A narrative assessment of the candidate's performance with respect to each of the characteristics of a partner or principal should be submitted in this part of the profile.

- ☐ *Ability to contribute to the growth of the firm* means encouraging existing clients to utilize all of the firm's services. It indicates exercising personal initiative to obtain new clients and having the ability to make high quality, successful presentations to bring in new engagements and new clients. It also means making a positive contribution to the firm's staff recruitment, education, development and retention efforts.
- ☐ *Business sense.* The good business person possesses sound business knowledge and judgment and demonstrates these characteristics in seeking new clients and retaining existing ones. He or she applies good business strategy in estimating fees, is profit oriented, timely in billings and collections, contributes an adequate margin to the firm's profits and is an efficient and effective administrator.
- ☐ *Executive presence* is the image an individual portrays in the company of others. A person with executive presence has stature, integrity and moral courage, is highly motivated and has a personality which leaves a lasting positive image. He or she demonstrates professionalism by personal conduct and grooming and by an enthusiastic attitude toward the firm. Subordinates seek this person's advice and counsel, and superiors seek his opinion.

Performance evaluation should be an ongoing process and should take place at least annually for managers and after completion of an assignment for staff accountants. Personnel should be graded on how well they meet the firm's standards in the above-mentioned areas and on their communicational ability, taking into consideration their different responsibilities and experience. Managers must also be evaluated on their potential for admission to the firm.

A performance report should be completed and used as a guide by the evaluator in discussions with managers and staff people. The performance report should be regarded as the starting point in evaluating a person and not as a replacement for day-to-day coaching. And the evaluation should address positive as well as negative aspects of performance and deal in specifics, candidly and constructively.

All partners must assume their share of the financial burden of running the practice, but obviously, if partners are to be retained, the financial arrangements concerning the capital account, compensation and retirement, etc., must be realistic and fair. Continuous partner evaluation and goal setting can aid partner retention by providing a basis for

- ☐ Fairness and equity in financial matters.
- ☐ Motivating people by recognizing their accomplishments and contributions to the firm through advancement and monetary rewards.
- ☐ Making sure that the partners work in areas which effectively use their talents through early determination of their capabilities, potential and readiness for greater responsibilities.
- ☐ Aiding career development by allowing partners to capitalize on their strengths and to minimize or correct weaknesses.
- ☐ Maintaining motivation through the many performance and directional changes that a partner may go through in a long career.

(Readers may wish to refer to the August and September 1978 issues of the *Practitioner* for some more ideas on personnel evaluation.)

Partners must be more than mere technicians and care should be taken that they do not put in too many chargeable hours with too many clients. If partners do have excessive chargeable hours, it could mean that they are not keeping up with technical changes, professional activities, civic duties or meeting often enough with the clients on a social basis.

A firm's profitability is increased by growing with its clients, expanding to new areas of service, upgrading its staff and handling more difficult engagements. A planned development of its human resources will provide the organizational strength for the success and continuity of the firm.

–by Harry E. Ward, CPA
Fort Worth, Texas

Focus on Estate Planning

The AICPA will hold its second annual estate planning conference from August 6 to 14 at Lincolnshire Resort in Illinois. The focus will be on the financial, tax and administrative aspects of estate planning at an advanced level.

Registrants should have attained a supervisory level in practice, attended certain basic estate planning courses or had extensive experience.

The registration fee is $275. For further information, contact Akshay Talwar at the AICPA.

Get Your Clients' Assets in Shape

The May 1978 *Journal of Accountancy* included an excellent article, "Personal Financial Counseling by CPAs—A Neglected Service." The article discusses the scope of financial counseling services and the role to be played by the CPA.

For several years, I have also been excited by the tremendous opportunities in providing financial planning assistance to executives and professionals. Together with Durwood Alkire, I recently coauthored a book, *Wealth—How to Achieve It.** Because of this book and our counseling experiences, we've been able to discuss personal financial planning with a variety of audiences, and have designed and presented seminars to many companies and professional organizations.

We have found that many people need a structure to follow in accumulating data on their present financial situations and in evaluating alternative plans for the future.

To assist clients in obtaining needed information, we designed a simple set of questions keyed to worksheets found in our book and to the seven major areas of financial planning we suggest they analyze when developing or updating their plans. Clients are asked to complete the questionnaire prior to a counseling session. This helps them determine where they are headed, make more effective use of advisors and keep costs down.

Here are some of the more significant questions.

Net Worth

- ☐ What are you worth in dollars (approx.)?
- ☐ Of what does your net worth consist?
- ☐ Complete the net worth worksheet.
- ☐ Do you have a net worth goal for
  (1) Five years from now?
  (2) Ten years from now?
  (3) Retirement?
- ☐ If you don't have a net worth goal, state the reasons why.
- ☐ What action do you have to undertake to reach your goals?
  (1) What rate of return do you need (after tax)?
  (2) How much do you have to invest each year to obtain it?
  (3) Which specific investments will accomplish your goals?
  (4) How do you plan to monitor your investment performance?

Income and Expenditures

- ☐ List your current income from all sources.
- ☐ What changes do you anticipate in the next five years that will significantly affect your income (favorably and/or unfavorably)?
- ☐ List the types of expenditures and amounts that you believe you cannot very easily avoid, given your present standard of living.
- ☐ What major discretionary expenditures (other than education) do you plan to make within the next five years (e.g., new car, travel)?
  (1) Rank these expenditures in order of priority.
- ☐ What is the estimated cost of educating your children?
  (1) When will the expenditures be required?
  (2) How will you fund them?
- ☐ What plans do you have for retirement?
  (1) At what age do you plan to retire?
  (2) At what income level?
  (3) How will your retirement income be funded?

Cash forecasting and liquidity

- ☐ Do you have a cash forecast?
  (1) If not, how do you plan and control expenditures and investments?
- ☐ Complete the five-year cash forecast worksheet.
- ☐ How much in savings do you presently have?
  (1) How did you determine the present level of your savings?
  (2) What interest rate are you receiving on savings (after taxes)?
- ☐ What's the inflation rate?
  (1) How does your after-tax interest rate on savings compare with the inflation rate?
- ☐ What other liquid investments do you know about (e.g., treasury bills, money-market mutual funds)?
  (1) What do they return?
  (2) If they return more than you are presently obtaining, why don't you invest in them?

Insurance

- ☐ How much life insurance do you have?
  (1) How did you determine the face amount?
  (2) When did you analyze your needs?
  (3) Who assisted you?
  (4) How objective was the analysis?
  (5) Did you understand the analysis?
  (6) Update the analysis of your insurance needs.

*May be purchased by enclosing a check for $11.75 to Financial Independence, P.O. Box 21268, Seattle, Washington 98111.

FIVE-YEAR CASH FORECAST WORKSHEET

	First Year	*Second Year*	*Third Year*	*Fourth Year*	*Fifth Year*
Income: Salary Other					
Total income Committed expenditures: Basic Taxes Savings Insurance Investments Other					
Total Excess (deficiency)					
Discretionary expenditures: Somewhat Very					
Total Cash available or Cash (required)					
Cumulative requirements					

NET WORTH WORKSHEET
AS OF ________________

Assets	*Estimated current value*	**Liabilities**	*Estimated current value*
Cash (checking and savings accounts)	$______	Short-term obligations:	
Term savings accounts	$______	Current bills	$______
Short-term investments	$______	Borrowings on life insurance	$______
Marketable securities	$______	Automobile(s)	$______
Accounts receivable	$______	Notes and contracts payable	$______
Cash value of life insurance	$______	Other	$______
Real estate	$______	Personal loans (give details on back)	$______
Investment partnerships	$______	Accrued taxes	$______
Special situations	$______		
Retirement funds	$______	Long-term obligations:	
Residence	$______	Mortgages on real estate investments	$______
Furnishings	$______	Mortgage on personal residence	$______
Automobile(s)	$______	Other obligations	$______
Boat(s)	$______	Total liabilities	$______
Other:	$______		
Total assets	$______	Assets − liabilities = net worth	$______

Tax planning

- ☐ What is your marginal tax rate?
  (1) Is it likely to go higher?
- ☐ Do you engage in tax planning?
  (1) If not, why not?
  (2) When, during the year, do you engage in tax planning?
- ☐ What type of tax advisor do you use?
- ☐ What tax-planning ideas have you used?
- ☐ What tax-planning ideas do you have?
  (1) Which ideas do you favor and why?
- ☐ What action are you going to undertake to implement your tax-planning ideas?

Investments

- ☐ How much do you have invested today and in what types of investments?
- ☐ What factors (safety, liquidity, income or appreciation) influenced you the most when making investment decisions in the past?
- ☐ What has each investment returned?
  (1) Are you satisfied?
  (2) If you are dissatisfied, what action will you take?
- ☐ What amount will you have available annually to invest over the next five years?
- ☐ What factors are you likely to consider in future investment decisions?
- ☐ What type of investment advisors have you used?
  (1) How did you select them?
  (2) How have you evaluated them?

Estate planning

- ☐ What objectives do you want to achieve through your estate plan?
- ☐ Briefly describe how your objectives will be achieved through
  (1) Your and your spouse's will.
  (2) Any trusts you have established.
  (3) A gifting program.
- ☐ What federal estate and state inheritance taxes do you estimate will have to be paid if you died in the near future?
  (1) Who will pay the taxes and what assets will be used?
- ☐ What control of your estate do you think your spouse should have and why?
- ☐ When was the last time you had your will reviewed by a competent advisor?

–by W. Thomas Porter, Jr., CPA, Ph.D., Seattle

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